

**Report to the Senior Executive Council,  
Department of Defense**

## **FINANCIAL INDICATORS TASK GROUP**

### **Report FY03-1**

- **Recommendations on the identification, development and use of meaningful financial indicators, ratios, and analyses for the Department of Defense.**

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**December 18, 2002**

Report Documentation Page				Form Approved OMB No. 0704-0188	
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1. REPORT DATE <b>18 DEC 2002</b>		2. REPORT TYPE		3. DATES COVERED <b>00-00-2002 to 00-00-2002</b>	
4. TITLE AND SUBTITLE <b>Financial Indicators Task Group</b>				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) <b>Defense Business Board,1155 Defense Pentagon,Washington,DC,20301-1155</b>				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT <b>Approved for public release; distribution unlimited</b>					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT <b>Same as Report (SAR)</b>	18. NUMBER OF PAGES <b>17</b>	19a. NAME OF RESPONSIBLE PERSON
a. REPORT <b>unclassified</b>	b. ABSTRACT <b>unclassified</b>	c. THIS PAGE <b>unclassified</b>			

## FINANCIAL INDICATORS TASK GROUP REPORT

**TASK:** The Defense Business Practice Implementation Board (DBB) was tasked with providing recommendations on the identification, development and use of meaningful financial indicators, ratios, and analyses for the Department of Defense. The Board relied on private sector best practices in the development and implementation of the metrics. The use of these tools will be critical to the Secretary of Defense's efforts at Department-wide transformation, particularly as they relate to financial management.

The Task Group was asked to provide the following deliverables:

- 1) Identify 10-12 high-level financial management indicators that are meaningful and relevant to the senior decisionmaking process within the Department of Defense.
  - 2) Describe the value of the indicators to senior managers.
  - 3) Define a simple, repeatable methodology for gathering the information and construction of the indicators on a regular basis.
- DBB Task Group Chairman: William Phillips
  - Task Group Vice Chairman: Mike Powers, Accounting & Finance Policy and Analysis Directorate
  - DoD Task Group Sponsor: JoAnn Boutelle, Deputy Chief Financial Officer
  - DBB Task Group Special Consultant: Tom Cocozza
  - DBB Task Group Executive Secretary: Kelly Van Niman

**PROCESS:** Working with the Accounting & Finance Policy and Analysis Directorate and the Program and Budget Directorate, the Task Group reviewed the current presentation of DoD financial information in the Department's financial statements, and provided recommended metrics for immediate, senior level use and future best practices analysis and performance assessment. The metrics are built around four distinct financial performance areas:

- Operating Results
- Asset Management
- Liability Management
- Cash Management

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The Board followed two key assumptions when developing their recommendations. First, that financial performance indicators are generally most valuable when they are analyzed in the context of two to three years of “Actual” results and three to five years of “Planned” forecasts. Analyzing indicators in this context adds historical and future perspective that provides additional meaning to a current year’s results.

Second, many performance indicators will be more meaningful at the component reporting entity level than the Department of Defense (DoD) Agency-wide level. Most DoD operations occur at the component level rather than the DoD Agency-wide level, and therefore analysis should generally include both Agency-wide and component level perspectives. This is similar to a private sector organization that focuses on operating results for a specific division in addition to consolidated results.

**RESULTS:** On November 21, 2002, the DBB agreed to highlight a subset of 5 metrics that would be most immediately relevant to senior-level management of the Department. The remaining 8 metrics address other basic business practices of the Department. They will become increasingly important as initiatives such as the Financial Management Modernization Program (FMMP) result in robust business systems that fully comply with the CFO Act and the Government Results and Performance Act, as well as, the OMB Form and Content requirements.

The Task Group concluded that the Department’s goal should be a set of readily measurable, accurate, and timely metrics that, at the highest levels in the Department, provide a picture of financial health. They should provide the basis for comparative analysis between and within the Services and Defense Agencies. The metrics also should be readily comparable across the Federal Government to facilitate best practices analysis and performance assessment against other Federal entities, as well as, the basis of a report card to citizen stakeholders.

As depicted in Chart A, the Task Group identified 13 individual metrics, each of which falls into one of the four financial performance areas cited earlier. The first 5 of the 13 metrics were identified as priority measures to be used

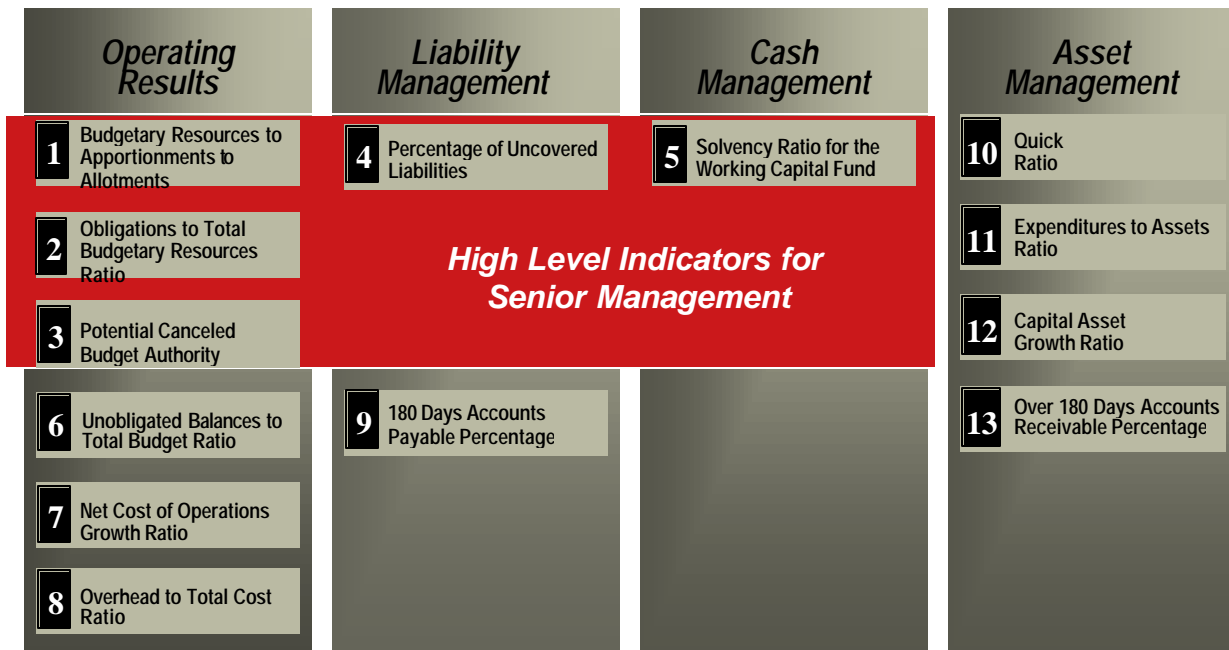
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immediately by senior management. The other 8 metrics remain important, but it is recommended that attention to them may be more appropriate at a level below the most senior managers in the Department.

Respectfully submitted,

William R. Phillips

### Chart A **FINANCIAL PERFORMANCE METRICS** *DoD Agency-wide Indicators*



Detailed descriptions of the metrics follow.

## FINANCIAL PERFORMANCE METRICS

### DoD Agency-wide Indicators

#### 1. Relationship of Total Budgetary Resources to Apportionments to Allotments

*(Highlights Management's Reserve)*

**Information Value:** Total Budgetary Resource by Year represents the total amount of funding authorized by Congress. It is similar to an operating budget in the private sector. Apportionments represent the amount apportioned by OMB that is available for distribution by OUSD Comptroller. Allotments represent the amount allotted/distributed by OUSD Comptroller to the various component organizations. Showing the relationship of Total Budgetary Resources to Apportionments to Allotments over time highlights trends in the management of total resources, apportionments and allotments.

#### Calculation:



*Source: Statement of Budgetary Resources. Total Budgetary Resources, Current and Prior Year (Line 1.F). For Apportionments, the balance of SGL account 4510, Apportionments should be extracted from DDRS. Account 4510 is displayed in Line 9, Apportioned, of the Statement of Budgetary Resources. Program Budget can provide Total Allotments to date.*

## 2. Obligations to Total Budgetary Resources Ratio

*(Highlights DoD's progress in executing programs)*

**Information Value:** The Obligations to Total Budgetary Resources Ratio presents the percentage of budget authority that has been obligated. It measures the ability of the organization to manage to the original budget. A ratio significantly under 100% indicates the organization's budget may not be aligned properly to its operations. One reason total budgetary resources would not be obligated fully includes use of multi-year appropriations that are obligated over several years.

### Calculation:

$$\frac{\text{Obligations Incurred}}{\text{Total Budgetary Resources}}$$

*Source: Statement of Budgetary Resources. Obligations Incurred (Line 2A). Total Budgetary Resources (Line 1.F).*

### 3. Potential Canceled Budget Authority

*(Trend highlights DoD's record to successfully execute programs)*

**Information Value:** Canceled Budget Authority is the amount of appropriation authority that is canceled five years after the expiration of an annual or a multi-year appropriation; or the amount of annual, multi-year or no-year appropriation authority that is canceled early by administrative action. Canceled Authority is lost to the organization, and should typically be managed close to a \$0 balance.

When calculated against the Department's Obligation Plan, this metric will highlight not only potential canceled budget authority, but also this indicator could be expanded to highlight expired authority that is below an established threshold, e.g., \$10 M. This will highlight potential solvency problems with expired authority.

#### Calculation:

Potential Canceled Budget Authority

*Source: Program Budget.*

*Note: For actual Canceled Budget Authority at the end of the year, see the Standard General Ledger (SGL) balance from the Defense Departmental Reporting System (DDRS). DDRS is the compilation source system for the Statement of Budgetary Resources. The specific SGL account is 4350, Canceled Authority. Account 4350 is not a standalone number on the Statement.*



#### 4. Percentage of Uncovered Liabilities

*(Trend analysis highlights budget resource exposure)*

**Information Value:** The Percentage of Uncovered Liabilities describes the relationship between Total Liabilities Not Covered by Budgetary Resources and Total Liabilities. These are DoD liabilities for which budgetary authority is not currently available. There is no ideal value as many long-term liabilities are funded year to year. This indicator is best analyzed as a trend over time. Analysis of this indicator will help budget analysts in aligning budget decisions to long-term liabilities.

#### Calculation:

$$\frac{\text{Total Liabilities Not Covered by Budgetary Resources}}{\text{Total Liabilities}}$$

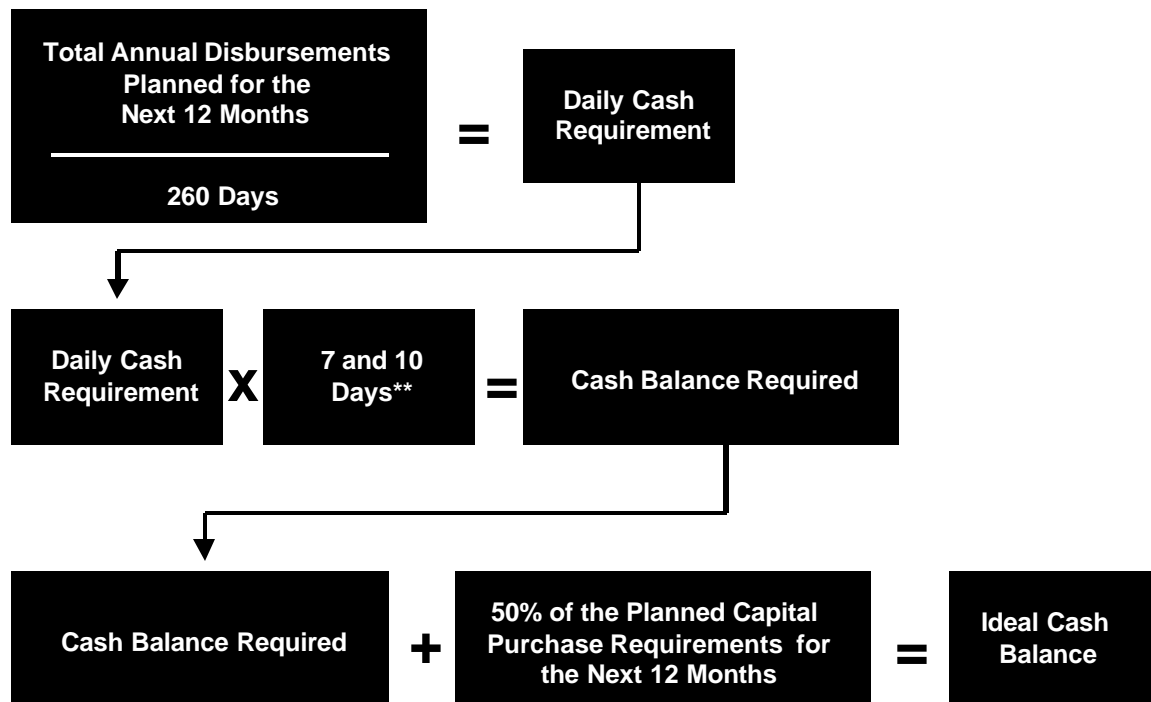
*Source: Note 11, Liabilities. Total Liabilities Not Covered by Budgetary Resources (Column 2, Line 3). Total Liabilities (Column 3, Line 3).*

## 5. Solvency Ratio -- Working Capital Fund

*(Highlights shortfall, if any, of required cash balances)*

**Information Value:** The Solvency Ratio describes the expected cash balance on hand for WCF activities using data from the reporting entity level. Forecasting the difference between ideal cash balances required and actual cash balances, allows management to realign expenses and/or cash reserves to address cash shortfalls.

### Calculation:



**Ideal Cash Balance is compared throughout the year to Actual Cash.**

Source: Program Budget.

\*\* Program Budget performs this calculation for both 7 and 10-day scenarios to calculate a range of results.

**6. Unobligated Balances to Total Budgetary Resources Ratio**  
*(Highlights resources in jeopardy of expiration)*

**Information Value:** The Unobligated Balances to Total Budgetary Resources ratio presents the percentage of budget authority that has NOT been used. This indicator presents the opposite perspective from the Obligations to Total Budgetary Resources ratio. A high percentage, or upward trend, may suggest further analysis is needed on the alignment of the budget to operational requirements.

**Calculation:**

$$\frac{\text{Unobligated Balances Available} + \text{Unobligated Balances Not Available}}{\text{Total Budgetary Resources}}$$

*Source: Statement of Budgetary Resources. Unobligated Balances – Available (Line 2.B) + Unobligated Balances – Not Available (Line 2.C). Total Budgetary Resources (Line 1.F).*

## 7. Net Cost of Operations Growth Rate

*(Trend analysis highlights spikes, if any, in operational costs)*

**Information Value:** Net Cost of Operations is the gross cost incurred by the organization less any exchange revenue earned from its activities. This is the equivalent of an Income Statement in the private sector, however, the “bottom line” is cost, not profit. This indicator highlights the percentage growth rate of Net Cost of Operations over the current year, starting from the prior year balance. There is no right or wrong percentage, rather the indicator should support funding plans for each organization. This indicator will be most useful in comparing organization-to-organization, and program-to-program on a trend basis, much like private sector managers would track product-by-product performance over time. Management also may wish to see a trend analysis comparing the Net Cost of Operations Growth Rate to Total Obligation Authority Growth Rate to highlight any imbalances between the two growth rates.

### Calculation:

$$\frac{\text{Net Cost of Operations (current year)} - \text{Net Cost of Operations (prior year)}}{\text{Net Cost of Operations (prior year)}}$$

Source: Statement of Net Costs. Net Cost of Operations (Line 4, Current and Prior Years).

## 8. Overhead to Total Cost Ratio

*(Future indicator to trend overhead growth rate)*

**Information Value:** The Overhead to Total Cost Ratio describes the percentage relationship of Costs Not Assigned to Programs to Total Costs. This is similar to overhead or non-product/service costs in the private sector. Most costs should support DoD programs. However, generally there will be some overhead costs not appropriately allocated to one or more programs. While the ideal percentage will vary organization-to-organization, an upward trend indicates that true overhead is increasing as a percentage of total cost. This ratio is recommended to be a future indicator once the Department implements systems that capture and assign costs to programs and overhead.

### Calculation:

$$\frac{\text{Costs Not Assigned to Programs} - \text{Earned Revenue Not Attributable to Programs}}{\text{Net Cost of Operations}}$$

*Source: Statement of Net Costs. Current Year Cost Not Assigned to Programs (Line 2) – Earned Revenues Not Attributable to Programs (Line 3). Net Cost of Operations (Line 4).*

## 9. Over 180 Days Accounts Payable Percentage

*(Highlights DoD's ability to manage cash flow)*

**Information Value:** The Over 180 days Accounts Payable Percentage highlights the amounts of Intra-governmental and Non-federal Payables over 180 days old. Ideally, the percentage rate should be very low. Most payables should be disbursed within a 6-month period.

### Calculation:

$$\begin{array}{ccc} \text{Intra-governmental} & \div & \text{Intra-governmental} \\ \text{Payables over} & & \text{Payables} \\ \text{180 Days} & & \end{array}$$

**AND**

$$\begin{array}{ccc} \text{Non-federal} & \div & \text{Non-federal} \\ \text{Payables over} & & \text{Payables} \\ \text{180 Days} & & \end{array}$$

*Source: Note 12, Accounts Payable. Column 3 and supporting disclosures. Note: disclosure of payables over 180 days is not currently required in the instructions to Footnote 12. Recommend this disclosure requirement be added.*

## 10. Quick Ratio

*(Measures short-term solvency and need for additional budget resources)*

**Information Value:** The Quick Ratio describes the percentage of liquid assets available to pay current liabilities. It is commonly used in the private sector as an indicator of short-term solvency. The percentage generally should be 100% or higher. A percentage under 100% indicates a potential immediate requirement for additional budget resources.

### Calculation:

$$\frac{\text{Fund Balance} + \text{Current Accounts Receivable} + \text{Cash and Other Monetary Assets}}{\text{Total Liabilities Covered by Budgetary Resources}}$$

*Source: Balance Sheet. Current Year Fund Balance with Treasury (Line 1.A.1) + Accounts Receivable (Line 1.A.3 + Line 1.C) + Cash and Other Monetary Assets (Line 1.B). Note 11, Liabilities Covered and Not Covered by Budgetary Resources. Total Liabilities Covered by Budgetary Resources (Column 1, Line 3).*

*\* The Accounts Receivable balance must be analyzed for receivables that are long-term and not available for current operations. These long-term receivables should be excluded from the calculation. By definition, these receivables should be rare. An example of a long-term receivable is a receivable that is in litigation.*

## 11. Expenditures to Assets Ratio

*(Trend analysis highlights requirement for additional budgetary resources)*

**Information Value:** The Expenditures to Assets Ratio measures the relationship of obligations to the asset base. It describes the relationship of costs to assets. There is no right or wrong percentage in DoD, as some organizations are asset intensive and some are not. This indicator is best viewed in the context of trends over time. An increasing ratio might indicate that more costs may be required to maintain a stable asset base, or alternatively that the asset base is decreasing in value.

### Calculation:

$$\frac{\text{Obligations Incurred}}{\text{Average Total Assets}}$$

*Source: Statement of Budgetary Resources. Obligations Incurred (Line 2.A.) Balance Sheet. Total Assets Current Year + Total Assets Prior Year divided by 2 (Line 2).*



## 12. Capital Asset Growth Rate

*(Future trend to assist management in identifying their position in the capital asset life cycle)*

**Information Value:** The Capital Asset Growth Rate describes the percentage growth rate of capital assets. There is no ideal percentage for this indicator; rather, the trend should demonstrate the organization's effectiveness in implementing capital planning requirements.

The components of this indicator will change significantly over the next several years as military equipment is valued and recorded on the Balance Sheet (classified as General Property, Plant and Equipment).

### Calculation:

$$\frac{\begin{array}{c} \text{Inventory and Related Property} \\ \text{(current year)} \\ + \\ \text{General Property, Plant and} \\ \text{Equipment} \\ \text{(current year)} \end{array} - \begin{array}{c} \text{Inventory and Related Property} \\ \text{(prior year)} \\ + \\ \text{General Property, Plant and} \\ \text{Equipment} \\ \text{(prior year)} \end{array}}{\begin{array}{c} \text{Inventory and Related Property} \\ \text{(prior year)} \\ + \\ \text{General Property, Plant and} \\ \text{Equipment} \\ \text{(prior year)} \end{array}}$$

*Source: Balance Sheet. Inventory and Related Property, Current Year and Prior Year (Line 1.E). General Property, Plant and Equipment, Current Year and Prior Year (Line 1.F).*

### 13. Over 180 Days Accounts Receivable Percentage

*(Highlights DoD's ability to manage cash flow)*

**Information Value:** The Over 180 days Accounts Receivable Percentage highlights the amounts of Intra-governmental and Non-federal Receivables over 180 days old. This “aging” of accounts receivable is performed commonly in the private sector. Ideally, the percentage rate should be very low. Most receivables should be collected within a 6-month period.

#### Calculation:

$$\begin{array}{ccc} \text{Intra-governmental} & \div & \text{Intra-governmental} \\ \text{Receivables over} & & \text{Receivables} \\ \text{180 Days} & & \end{array}$$

**AND**

$$\begin{array}{ccc} \text{Non-federal} & \div & \text{Non-federal} \\ \text{Receivables over} & & \text{Receivables} \\ \text{180 Days} & & \end{array}$$

*Source: Note 5, Accounts Receivable. Column 1 and supporting disclosures.*